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IN THE

Supreme Court of the United States

October Term, 1962
No. 423

PAUL F. BRUNING,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above-entitled case on May 3, 1963.

Citations to Opinions Below.

The opinion of the United States District Court is reported as *Bruning v. United States,* 192 Fed. Supp. 826 and the opinion of the United States Court of Appeals for the Ninth Circuit is reported at ..... F. 2d ....., 11 AFTR 2d 1443. The opinions of the United States District Court and the Circuit Court of Appeals are printed in Appendix B hereto.

Jurisdiction.

The judgment of the Court of Appeals was entered May 3, 1963. On August 2, 1963 Justice Byron R. White issued an order extending the time to file this petition to September 2, 1963. Jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

Question Presented.

Whether Petitioner Is Liable to Pay Interest on His Federal Tax Liability Accrued Subsequent to the Date of His Being Adjudicated Bankrupt Out of His Own Assets Acquired Subsequent to the Adjudication of Bankruptcy.

Statutes Involved.

The statutory provisions involved are §6873(a) Internal Revenue Code of 1954 (26 U. S. C. A. 6873(a)), §57(j)(n) Bankruptcy Act (11 U. S. C. A. 93 j.n.) and §17(a)(1) Bankruptcy Act (11 U. S. C. A. 35 (a)(1)). They are printed in the Appendix A hereto.

Statement.

Petitioner, doing business in the state of Louisiana as Bruning Construction Company, incurred withholding and federal insurance contributions taxes during the fourth quarter of the year 1951 but failed to pay said taxes when due. In March, 1952, an assessment was made against petitioner. On July 6, 1953, petitioner filed a voluntary petition in bankruptcy and was on that same day adjudicated a bankrupt in the Western District of Louisiana. The District Director of Internal Revenue at New Orleans filed a claim in the bankruptcy proceedings for said assessment. No dividend was received by the general creditors in the bankruptcy pro-

ceeding and the dividend on priority claims, including taxes; was prorated. The United States received a small distribution which was applied to said assessment. The petitioner was granted a discharge in bankruptcy in October, 1953, and the case was closed in June, 1954.

Certain adjustments were made with regard to the assessment by virtue of payments and credits. On June 22, 1959 petitioner filed a claim for refund of $955.81 which he claimed was unlawfully accrued as interest between the date of his bankruptcy on July 6, 1953 and March 7, 1958, the day of the final payment of withholding and FICA taxes assessed for the fourth quarter of 1951. The claim for refund was rejected and action timely commenced within a two year period. The amount in dispute was later reduced from $955.81 to $795.40.

Reasons for Granting the Writ.

(1) The decision of the Court below in the instant case is directly in conflict with the decision of the Tenth Circuit Court of Appeals in *United States v. Mighell*, 273 F. 2d 682, 5 AFTR 2d 473. This conflict was conceded in the Court below in the following words: "Although it probably sets up a conflict with *United States v. Mighell*, 10 Cir., 273 F. 2d 682, we choose to follow our trial Court's decision."

(2) The issue presented is clearly one of importance in the administration of the tax laws of the federal government and of the states and their subdivisions. Settlement of the question is plainly in the public interest, since it is likely to be presented in almost every case where there is an unsatisfied claim for taxes asserted by the federal government or a state or subdivision thereof in a bankruptcy proceeding.

While the petitioner has no official data available it is believed that hundreds of cases are now pending which involve tax claims of the federal government, states and subdivisions thereof in bankruptcy proceedings.

(3) The decision below is believed to be erroneous and not only in conflict with the decision of the Tenth Circuit in *United States v. Mighell, supra,* but it appears also to be in conflict with the holding of this Court in *City of New York v. Saper,* 69 S. Ct. 554, 336 U. S. 328 for the reasons given below.

The Government concedes that post-bankruptcy interest cannot be recovered against the bankrupt's estate but wishes to reinstate interest so that it can reach after acquired assets of the bankrupt. There is nothing in logic, the bankruptcy laws or the tax laws to support such a proposition.

United States v. Mighell, supra, is on all fours with the case at bar. The Director of Internal Revenue was enjoined from asserting any claim against the bankrupts for interest accruing subsequent to the Petition in Bankruptcy. The Tenth Circuit, in affirming, said:

> "In the National Foundry case it was said that proceedings to collect were 'at best futile, at worst inimical to the future welfare of the newly reorganized corporation.' That statement applies here. *There is no significant distinction between a reorganized corporation struggling to regain financial health and an individual seeking relief from overburdensome debts.* The issuance of the injunctive order in the circumstances of this case was not an abuse of discretion." (5 AFTR 2d 475). (Emphasis supplied).

In the *Saper* case, *supra*, Mr. Justice Jackson, who had, previous to his appointment to the Supreme Court, been the Chief Counsel of the Bureau of Internal Revenue, by way of preface to the Opinion reviewed the development of the rule concerning post-bankruptcy interest as follows:

> "If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than forty years ago, Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied.
>
> * * * * *
>
> Section 63, sub. a(5), 11 USC §103, sub. a(5), 11 USCA §103, sub. a(5), allows interest only to that date on debts reduced to judgment after bankruptcy. *No provision permits post-bankruptcy interest on other claims in general or tax claims in particular.* Section 57, sub. j, 11 USC §93, sub. j, 11 USCA §93, sub. j, forbidding allowance of governmental penalties or forfeitures permits allowance of losses sustained by the acts penalized, with actual costs and 'such interest as may have accrued thereon according to law'. However, on its face this appears to delimit even such allowable debts as of the date of bankruptcy and to allow no more interest than does §63 with respect to the claims there specified. *Moreover, there is no in-*

terest except that which accrues according to law—it is exactly such interest that the 'fundamental principle' cuts off as of bankruptcy." (Emphasis supplied.)

Conclusion.

For the foregoing reasons this petition for a writ of certiorari should be granted.

Dated August 27, 1963.

Respectfully submitted,

ERNEST R. MORTENSON,
Attorney for Petitioner.

APPENDIX A.

§6873(a) Internal Revenue Code of 1954 (26 USCA 6873(a)):

"UNPAID CLAIMS.

(a) General Rule.—Any portion of a claim for taxes allowed in a receivership proceeding or any proceeding under the Bankruptcy Act which is unpaid shall be paid by the taxpayer upon notice and demand from the Secretary or his delegate after the termination of such proceeding."

§57(j)(n) Bankruptcy Act (11 USCA 93 j. n.):

j. "Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

n. "Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or any subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed."

§17(a)(1) Bankruptcy Act (11 USCA 35(a)(1)):

17(a)(1). "Debts Not Affected by a Discharge. a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality;"

APPENDIX B.

Memorandum of Decision.

United States District Court, Southern District of California, Central Division.

Paul F. Bruning, Plaintiff, vs. United States of America, Defendant. No. 561-60 WB.

Filed April 10, 1961.

Plaintiff incurred liability for withholding and Social Security taxes as an employer for the fourth quarter of the year 1951, but failed to pay more than a portion of this liability. On July 6, 1953, he filed a voluntary petition in bankruptcy and was on the same day adjudicated a bankrupt. The District Director of Internal Revenue filed a claim in the bankruptcy proceedings for the delinquent taxes. No dividend was received by the general creditors in the bankruptcy proceedings and the dividend received by the defendant on its priority claim for taxes was only a fraction of the assessed amount. Plaintiff was granted a discharge in bankruptcy on October 29, 1953.

In 1957 plaintiff filed claims for the refund of his income taxes paid for the years 1953 and 1954. These claims were audited and plaintiff was allowed a net operating loss which gave rise to a deduction and thus a credit for income taxes and interest paid for the years 1953 and 1954.

On March 7, 1959, the Director of Internal Revenue applied the entire 1953 credit and a part of the 1954 credit against the balance of the assessment of the withholding and FICA taxes for the fourth quarter of 1951 plus accrued interest and additions to tax computed to that date. Of the amount so applied, a por-

tion was allotted to the interest and additions to taxes accrued to that date. (Defendant concedes errors in the computation of interest, which will give plaintiff an overpayment of $40.40 in any event.) The amount of interest which had accrued during the period between the filing of petition in bankruptcy on July 6, 1953, and the date of credit March 7, 1958, was $759.-40, and is the amount involved in this action.

The plaintiff has satisfied all jurisdictional prerequisites to this suit for refund, having paid the post-petition interest, filed a claim for refund, and the refund having been denied.

The question for determination is whether interest on delinquent taxes claimed in the bankruptcy estate accrues after the filing of a petition in bankruptcy and is collectible from the taxpayer himself, who is discharged in bankruptcy. Both parties agree that such interest does not accrue on the claim *against the estate*. The narrow question presented is whether the interest may be collected from the taxpayer himself, by resorting to after-acquired assets or property except from the bankruptcy proceedings.

Plaintiff relies on the case of *City of New York vs. Saper*, 336 U. S. 320, 69 S. Ct. 554, 93 L. Ed. 710, where the Supreme Court held that tax claims against a *bankruptcy estate* bear interest only until the date of bankruptcy, not until payment. The Court's rationale appears at pages 330-332 of 336 U. S.:

> ". . . More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or

statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied. Sexton v. Dreyfus, 219 U. S. 339, 344. Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims. Every logical implication from relevant provisions is to the contrary. Section 63(a)(1), 11 U.S.C. §103(a)(1) allows interest on judgments only to date of bankruptcy. Section 63(a)(5), 11 U.S.C. §103(a)(5) allows interest only to that date on debts reduced to judgment after bankruptcy. No provision permits post-bankruptcy interest on other claims in general or tax claims in particular. Section 57(j), 11 U.S.C. §93(j), forbidding allowance of government penalties or forfeitures, permits allowance of losses sustained by the acts penalized, with actual costs and 'such interest as may have accrued thereon according to law'. However, on its face this appears to delimit even such allowable debts as of the date of bankruptcy and to allow no more interest than does §63 with respect to the claims there specified. Moreover, there is no interest except that which accrues according to law—it is exactly such interest that the 'fundamental principle' cuts off as of bankruptcy. Section 57(n), 11 U.S.C. §93(n) requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extension be granted. Tax claims are treated the same as other debts except for the fourth priority of payment, §64(a), 11 U.S.C. §104(a), and the provisions

making taxes nondischargeable, §17, 11 U.S.C. §35. But each of these sections is silent as to interest.

"The long-standing rule against post-bankruptcy interest appears implicit in our current bankruptcy Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so . . ."

The plaintiff's reliance appears misplaced, as the question here at issue was not considered in the *Saper* case, which involved interest on an unliened tax claim of the City of New York which the City attempted to collect from the *bankruptcy estate*, not from the taxpayer. The instant case concerns the liability of the taxpayer himself for such interest when collected from the taxpayer's assets acquired *after bankruptcy*. The *Saper* principle that tax claims against a bankrupt bear interest only until the date of bankruptcy, not until payment, has been applied by three Circuit Courts including our own, (*U. S. vs. Bass*, 271 F. 2d 129 (CA 9); *U. S. vs. Harrington*, 269 F. 2d 719 (CA 4), *In re Kerber Packing Co.*, 276 P. 2d 245 (CA 7)) and is the settled law, but it is not dispositive of this case.

The Tenth Circuit case of *U. S. vs. Mighell*, 273 F. 2d 682, would seem to support the plaintiff's position, as it affirmed the right of the lower court to enjoin the collection of post-petition interest on lien claims from the debtor himself after his discharge. In citing *U. S. vs. Bass*, supra, and *U. S. vs. Barrington*, supra, the *Mighell* court stated, "This contention of the United States has been rejected and post-bankruptcy interest on liened tax claims denied. As we agree with

those decisions, no good purpose would be gained by going over the same ground that they have covered adequately."

This conclusion rests, I believe, on a wholly unwarranted dependence on *Bass* and *Harrington*. It disregards the only issue that was before the court in each of those cases, and thereby misconceives the holding in each. Both *Bass* and *Harrington* were concerned with the issue of the *obligation of the bankruptcy estate* for post-petition interest on tax claims sought to be *proved and allowed in the estate*. It is true that both courts denied "post-bankruptcy interest on liened tax claims", but it was interest sought to be allowed and *collected from the estate*, not from the taxpayer. These courts both followed the Supreme Court holding in the *Saper* and *Dreyfus* cases that inherent in our bankruptcy law is a fundamental principle, taken from the English system, *viz.* the cutting off of interest *against the estate* at the time of bankruptcy. It does not follow that this interest may not be collected from the taxpayer after his discharge in bankruptcy when the other creditors are unaffected.

It is clear from *Bass* and *Harrington*, as well as *Saper* and *Dreyfus*, that the phrases "everything stops at a certain date", "interest cut off as of bankruptcy", relate to the obligations of the *bankruptcy estate* and not to those of the taxpayer. For example, if the estate turns out to be solvent and there is a surplus after the payment of all creditors' claims, the surplus *is supplied to creditors' claims for interest*, and not returned to the debtor. See also *Beecher vs. Leavenworth State Bank*, 192 F. 2d 10 (CA9) to the same effect. That the purpose of the "cut off" rule is to preserve the estate is

made manifest by the *Beecher* court in stating, "There is just as much danger of *eating up the bankrupt's estate* with interest on claims arising after the date of bankruptcy as with interest on claims arising before the date of bankruptcy. Consequently, the allowance of interest on these supplemental claims must be modified in the same manner as the other secured claims." (emphasis supplied)

The *Saper* case (336 U.S. at page 338) cited *American Iron Co. vs. Seaboard Air Line,* 233 U.S. 251, as stating the correct rule. The latter case held (233 U.S. at pages 266, 267) that the rule stopping interest from accruing against the estate "did not prevent the running of interest" and cited with approval *Johnson vs. Norris,* 190 F. 459, where the court stated at page 463, "It is true, as a general rule, that, where property of an insolvent passes into the hands of the court, subsequently accruing interest is not allowed against the fund. (citing case). This principle is applied *as between creditors claiming the fund.*" (emphasis supplied)

The Internal Revenue Code of 1939 governs the liability for interest on taxes[1] and provides that in case of delinquency there *shall be added as part of the tax,* interest at the rate of six per centum per annum from the date the tax became due until paid. The Code provides that a lien arises with respect to any delinquent tax, that it includes interest and "shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time."[2]

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[1] §§ 1623, 1627, 1420(b).
[2] §§ 3670, 3671.

The Bankruptcy Act expressly excepts taxes from discharge[3] and the clear language of the revenue statute *adds interest to the tax*. The result is that interest added to the tax is excepted from discharge. There is nothing in the Bankruptcy Act, the Internal Revenue Code or the "fundamental principle of the English bankruptcy system" which should compel or permit a contrary conclusion.

Dated April 10, 1961.

WM. M. BYRNE,
United States District Judge.

[3] § 17 (11 U.S.C.A. 35).

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Paul F. Bruning, Appellant, vs. United States of America, Appellee. No. 17,445.

May 3, 1963.

Appeal from the United States District Court for the Southern District of California, Central Division. Before: CHAMBERS and BARNES, Circuit Judges.[1]

CHAMBERS, Circuit Judge:

Paul F. Bruning has been through bankruptcy. At adjudication one of his debts was to the United States for withholding and social security taxes for the fourth quarter of the year 1951. The government participated in the bankruptcy estate, but its claim was only partially satisfied on distribution.

Bruning is entitled to an income tax refund for later years unless the government can offset the refund by charging him post bankruptcy interest (that is, after adjudication). The case gets into court because Bruning has filed claims with the director of internal revenue for a refund which were denied.[2] So he sought in the

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[1]John R. Ross, United States district judge for the District of Nevada, was the third member of the division which heard the arguments. His death occurred on April 22, 1963. Therefore, he has not participated in the decision herein.

[2]As of the date of adjudication of bankruptcy on July 6, 1953, the principal balance on the unpaid taxes was about $3,000.00. This was reduced by about $700.00 by a distribution in the estate. Appellant Bruning does not question the director's right to deduct the principal balance from his refund. What is at issue in this case is the right of the director to deduct about $800.00 in post bankruptcy interest.

district court to obtain the money from the United States. This he was denied by the district court. Bruning v. United States, 192 F. Supp. 826. Although it probably sets up a conflict with United States v. Mighell, 10 Cir., 273 F.2d 682, we choose to follow our trial court's decision.

Section 17a. of the Bankruptcy Act (11 U.S.C. §35a.) provides as follows:

"DEBTS NOT AFFECTED BY A DISCHARGE.—a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; or (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on

salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; or (6) are due for moneys of an employee received or retained by his employer, to secure the faithful performance by such employee of the terms of a contract of employment."

Obviously, under the above section insofar as the principal amount of tax debt was not satisfied out of the bankruptcy estate, the taxpayer would remain liable after his discharge.

It is well settled that as between the tax collector and the bankrupt estate that interest is suspended[3] as of the time of adjudication, City of New York v. Saper, 336 U.S. 328; United States v. Bass, 9 Cir., 271 F.2d 719; and In Re Kerber Packing Co., 7 Cir., 276 F.2d 245. But if the estate is adequate and more to pay all claims which had accrued (including interest) as of the date of the bankruptcy then as between the debtor and the creditors, the latter get from the estate post bankruptcy interest. So even in the estate post bankruptcy interest is not gone for all purposes. American Iron Co. v. Seaboard Air Line, 233 U.S. 261; Brown v. Leo, 2 Cir. 34 F.2d 127.[4]

Some of the cases denying relief for the extra interest out of the estate do speak of compassion for the debtor or of what will restore the debtor's economic health. For example, see National Foundry Company of N.Y. v. Director of Internal Revenue, 2 Cir., 229 F.2d 149.

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[3]One exception of course is negotiated security transactions. To the extent the security is adequate, interest is allowed against the res of the security during administration. Palo Alto Mutual Savings and Loan Ass'n v. Williams, 9 Cir., 1957, 247 F.2d 777.

[4]Provable claims in bankruptcy are covered by Section 63 of the Act (11 U.S.C. § 103).

But, if paying interest on one's taxes after discharge is inimical to an ex-bankrupt's health, so is the payment of any balance of principal.

Section 17a. is not a compassionate section for debtors. Congress, speaking for society, has decided that the problems of others: the government, the abandoned-dependent wife, the defrauded widow, overide the value of giving the debtor a wholly new start in life.

There is language in City of New York v. Saper, trustee, supra, which is favorable to appellant here, but we think the holding, based upon the internal arrangements of the bankruptcy estate, does not require us to reverse. Further, we believe our ruling consistent with our bankruptcy estate decision of United States v. Bass, supra.

This opinion need not be further continued to restate in a different way the published opinion of Bruning's case in the trial court cited hereinabove.

Legislation is not our business. It may well be that with taxes reaching a position of dominance in the whole bankruptcy field, when the government gives away so much, it ought to give away after bankruptcy the interest on its taxes. Maybe Congress should say so clearly. But if we did so would we not give away the interest of him who was defrauded, the victim of the willful and brutal injury, those who lost by embezzlement? Perhaps we could waive the interest of the holders of judgment for breaches of promises to marry without too many qualms. But how could we

choose among the beneficiaries of Section 17a? It must be admitted that taxes and more taxes so overshadow by general weight and burden the other protected debts of 17a. and that in most cases to talk of the other non-dischargeable debts is often theory. But the section was written on a day other than today.

Affirmed.

(Endorsed) Opinion Filed May 3, 1963.

Frank H. Schmid, Clerk.

APPENDIX C.

United States Court of Appeals
for the Ninth Circuit

No. 17445

Paul F. Bruning,

Appellant,

vs.

United States of America,

Appellee.

JUDGMENT

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is affirmed.

Filed and Entered May 3, 1963.